

ZIONS BANCORPORATION

HARRIS H. SIMMONS
Chairman, President and
Chief Executive Officer

February 22, 2011

Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW.
Washington, DC 20551

Re: Docket No. R-1404 and RIN No. 7100 AD63

Dear Ms. Johnson:

I'm writing on behalf of Zions Bancorporation, a bank holding company with assets of approximately \$51 billion, and nearly 500 branch banking offices throughout the western United States, to express our concern and opposition to the proposed rulemaking with respect to debit card interchange fees.

We appreciate that the Federal Reserve Board (the "Board") is attempting to carry out a legislative mandate to establish interchange fee price controls that are "reasonable and proportional to the cost incurred by the issuer with respect to the transaction," distinguishing between the incremental cost incurred by an issuer in the authorization, clearance, or settlement of a particular electronic debit transaction and other costs incurred by an issuer which are not specific to a particular debit card transaction.

We believe that, unless the Federal Reserve System interprets the concept of "incremental cost" more broadly than is currently contemplated by the proposed regulation, our nation's debit card system - which has become a critical payments channel for both depository institutions and merchants alike - will be in jeopardy of under-investment, increasing levels of fraud, a lack of continuing innovation, and the direct assessment of fees to cardholders, resulting in the diminished utilization of a system which facilitates, by the Federal Reserve's own estimates, approximately 35% of the payments activity in our economy.

In testimony last week before the House Subcommittee on Financial Institutions and Consumer Credit, Federal Reserve Governor Sarah Bloom Raskin noted that the statute giving rise to this proposed regulation requires the Board to *consider* the incremental cost of a particular transaction, and noted further that there is no good definition of "incremental cost." The Board is therefore effectively proposing that incremental cost be set equal to average variable cost. Governor Raskin explained that, under this view, "the exclusion of fixed costs is required by the statute's explicit directive that the Board may not consider costs that are not specific to a particular transaction." She suggests further that costs that do not vary materially over the relevant volume range are not variable costs, and should therefore be excluded.

We believe this is an unworkably narrow definition of the costs which should be taken into account in establishing limits on interchange fees. Unless the Board focuses on the full set of *proportional* (rather than variable) costs attributable to transactions - including a reasonable profit inherent in the cost of capital, banks will be asked to provide these services at less than full cost, and the debit card payments system as we have known it will surely deteriorate and may ultimately disappear in favor of other payments alternatives not similarly handicapped.

Capital equipment costs, security costs, compliance costs, fraud costs, network connectivity costs, personnel, occupancy and other overhead costs, among others, are necessary to the effective functioning of a debit card system. They may not be "variable" costs over a small volume

of transactions; but they are certainly *critical* costs in the sense that, if a financial institution does not incur these costs and allocate them proportionately to the debit card line of business, that business will no longer be economically viable. For instance, it may seem that costs attendant to expensive computer hardware are so small as to not warrant their calculation as variable costs with respect to any particular transaction. But without such hardware, no transactions can be processed. Viewed this way, the full set of costs attributable to the entire universe of debit card transactions are necessary for any *particular* transaction, and should be taken into account in a "reasonable and proportional" manner. "Incremental" costs should be considered to be the proportional amount of the full set of costs incurred in the entire range of activities necessary for the execution of *all* debit card transactions.

Governor Raskin, in commenting on the Board's deliberations with regard to the proposed regulations also noted the statute's mandate to consider the functional similarities between debit card and check transactions, and "the fact that these costs are not charged to merchants in check transactions." Any notion that merchants are not charged for the presentation of checks is simply incorrect. Checks do indeed clear "at par," but merchants have long been assessed the full set of costs associated with the clearing of checks, either via a direct per-deposited-item charge, or through a monthly "account analysis" to determine the amount of non-interest bearing deposit balances required to be maintained to offset such a charge.

Debit cards have proven to be of great value to both consumers and merchants alike. Their value to merchants is evidenced in no small measure by the fact that many merchants have discontinued accepting checks. Merchants bear the risk of a check being returned due to insufficient funds, which is minimized when the merchant is paid through the use of a debit card.

In our organization, we expect that the proposed regulation with respect to interchange fees will result in the loss of approximately \$50 million in annual revenue. This will severely handicap our ability to invest in the software, computer hardware, compliance resources, card issuance costs, customer support, marketing and other expenditures necessary to maintain a debit card program. Should the proposed interchange fee regulation be adopted in its current form, we will certainly attempt to capture much of this lost revenue directly from our cardholder customers. But we expect that we will also issue fewer cards, and that many customers will find the debit card fees or other monthly assessments to be unaffordable, with the result that they will close their accounts all together.

We respectfully ask that the Board reconsider its mandate, using a more expansive view of the costs that should be captured in establishing "reasonable and proportional" fees for this critical activity.

Sincerely,

A handwritten signature in black ink, appearing to read "Harris H. Simmons", written over a horizontal line.

Harris H. Simmons
Chairman, President and CEO
Zions Bancorporation